MARKET INSIGHTS

4Q | 2011

As of September 30, 2011

Guide to the Markets:

Investing in an Environment of Extremes

Dr. David Kelly

Chief Market Strategist

J.P.Morgan Asset Management

MARKET INSIGHTS

Highlights

- **The U.S. Outlook I: No Change in Prognosis**
- The U.S. Outlook II: Fiscal and Monetary Policy Risks
- Global Outlook I: The Problem with Europe
- Global Outlook II: Emerging Markets Carrying the Load
- Investment Opportunities in an Extreme Environment

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MARKET INSIGHTS

"Muddle-through" still the most likely scenario

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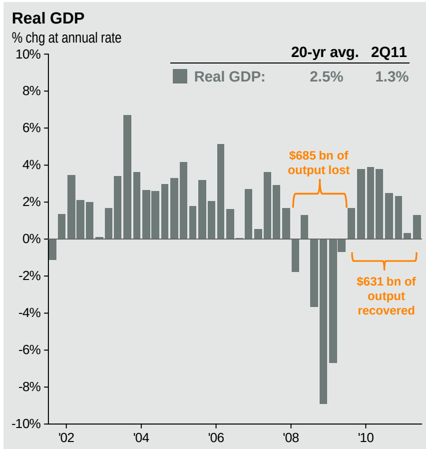
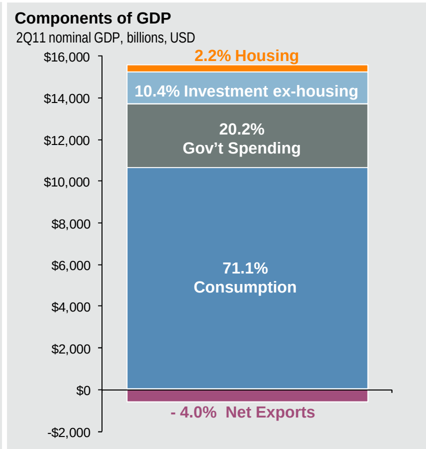
Economy





Source: BEA, FactSet, J.P. Morgan Asset Management.

GDP values shown in legend are % change vs. prior quarter annualized and reflect revised 2Q11 GDP.

Data reflect most recently available as of 9/30/11.

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Limited confidence impact so far on cyclical sectors

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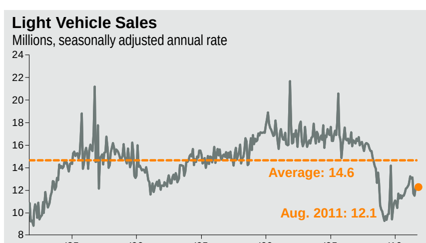
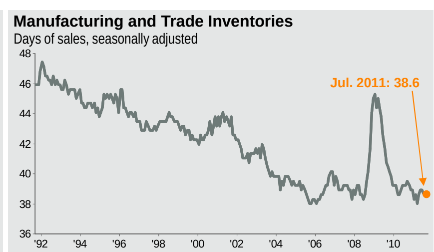
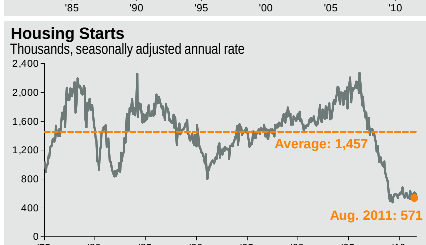
Economy







Source: (Top left) BEA, FactSet, J.P. Morgan Asset Management. (Top right) Census Bureau, FactSet, J.P. Morgan Asset Management. (Bottom left) Census Bureau, FactSet, J.P. Morgan Asset Management. (Bottom right) Census Bureau, FactSet, J.P. Morgan Asset Management.

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Fixing the deficit too quickly may be the biggest risk

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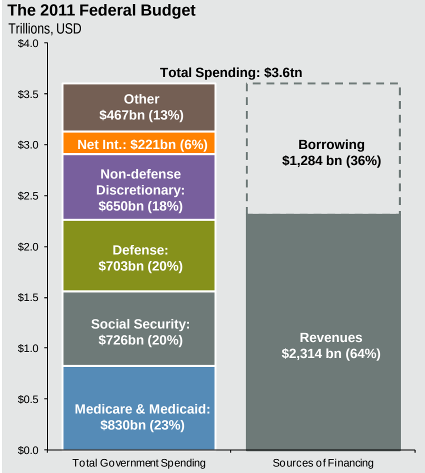
Economy

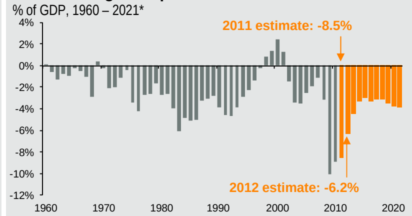
The 2011 Federal Budget

Trillions, USD



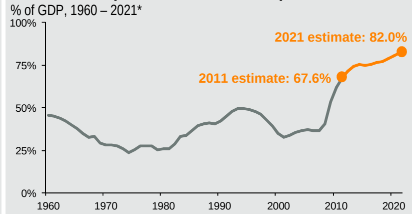
Federal Budget Surplus/Deficit

% of GDP, 1960 – 2021*



Federal Debt (Accumulated Deficits)

% of GDP, 1960 – 2021*



Source: U.S. Treasury, BEA, CBO, OMB, J.P. Morgan Asset Management.
2011 numbers are based on CBO August Baseline Scenario. *Estimates for 2011 – 2021 are based on August alternative scenario budget projections from the CBO's "Budget and Economic Outlook: An Update" which was released on August 24, 2011. The alternative scenario assumes an extension of all Bush tax cuts, annual adjustments to AMT and Medicare payment schedules and spending on operations in Afghanistan and Iraq rising from 2011 levels in line with inflation throughout the forecast period.
Note: Years shown are fiscal years (Oct. 1 through Sep. 30). Top right chart displays federal surplus/deficit (revenues – outlays).
Data reflect most recently available as of 9/30/11.

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MARKET INSIGHTS

Low rates for ever isn't helping the economy

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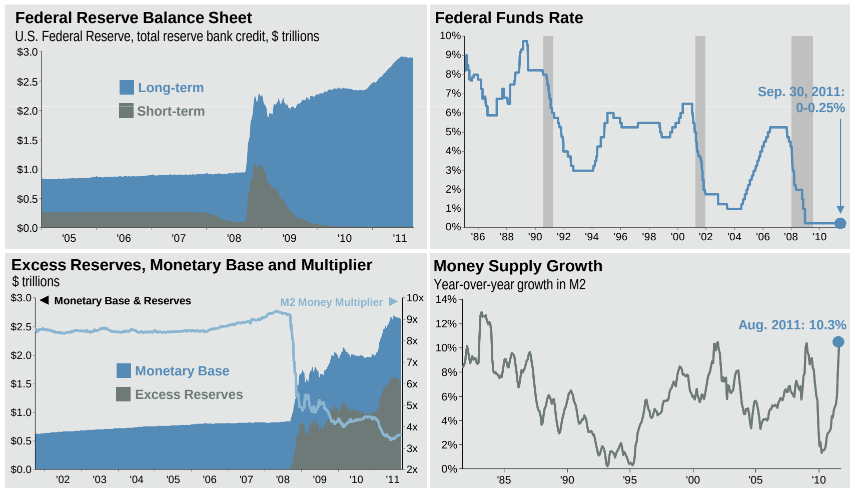
Fixed Income



Source: Federal Reserve, FactSet, J.P. Morgan Asset Management.

Monetary base is defined as the total amount of a currency that is either circulated in the hands of the public or in the commercial bank deposits held in the central bank's reserves. Money multiplier defined as M2 divided by the monetary base.

Data are as of 9/30/11.

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European Crisis: Fiscal Challenges

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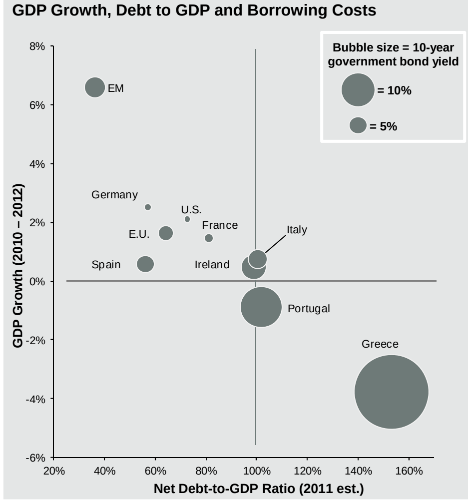
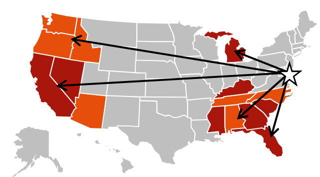
GDP Growth, Debt to GDP and Borrowing Costs



Example of Fiscal Redistribution in U.S.



The E.U. Lacks a Similar Fiscal Mechanism

International

Source: IMF, BLS, J.P. Morgan Asset Management.
Maps are for illustrative purposes only and are intended to show the current sources of stress in each region. The U.S. state colors are based on level of unemployment rate. European country colors are based on levels of sovereign stress, including but not exclusively the measure shown in the above chart on the left.
Data are as of 9/30/11.

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European Crisis: Financial System Risks

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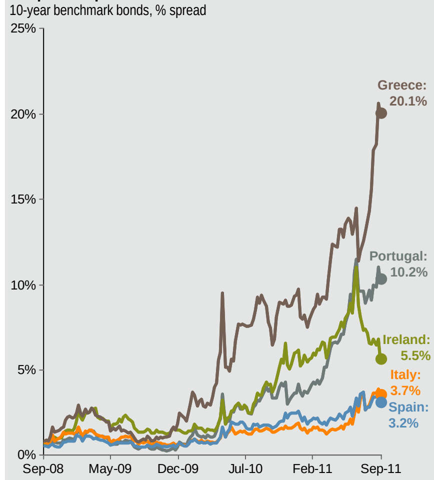
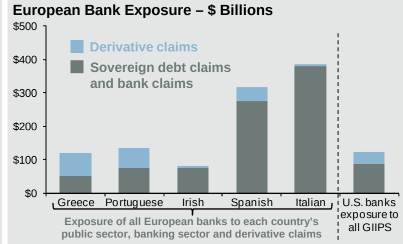
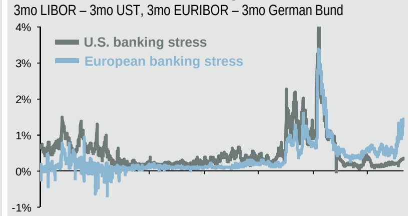
Peripheral Spreads to German Bunds
10-year benchmark bonds, % spread



European Bank Exposure – $ Billions



Interbank Short-term Lending Rates
3mo LIBOR – 3mo UST, 3mo EURIBOR – 3mo German Bund



International

Source: IMF, FactSet, Bloomberg, BIS, J.P. Morgan Asset Management.
Data are as of 9/30/11.

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- The U.S. Outlook III: Valuation Extremes
- **Global Outlook II: Emerging Markets Carrying the Load**
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Japan and EM should prevent global recession

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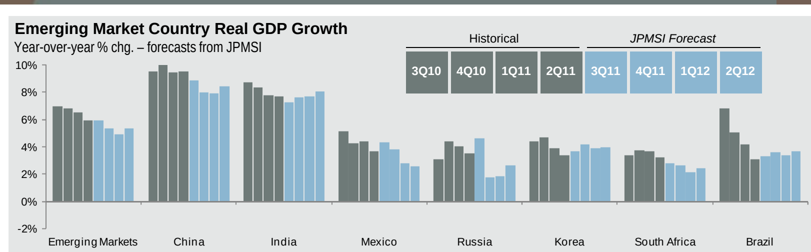
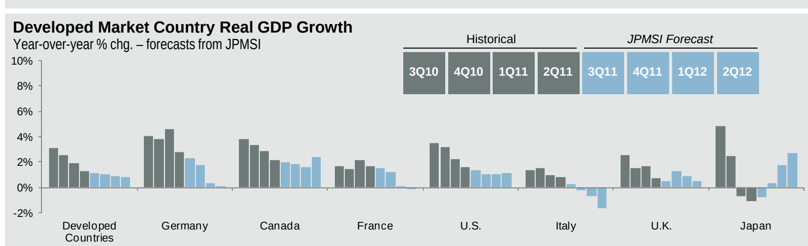
International





Source: J.P. Morgan Global Economic Research, J.P. Morgan Asset Management.
Forecast and aggregate data come from J.P. Morgan Global Economic Research.
Data reflect most recently available as of 9/30/11.

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- ➢Global Outlook I: The Problem with Europe
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- ➢**Investment Opportunities in an Extreme Environment**

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MARKET INSIGHTS

Real Treasury rates are at a thirty-one year low

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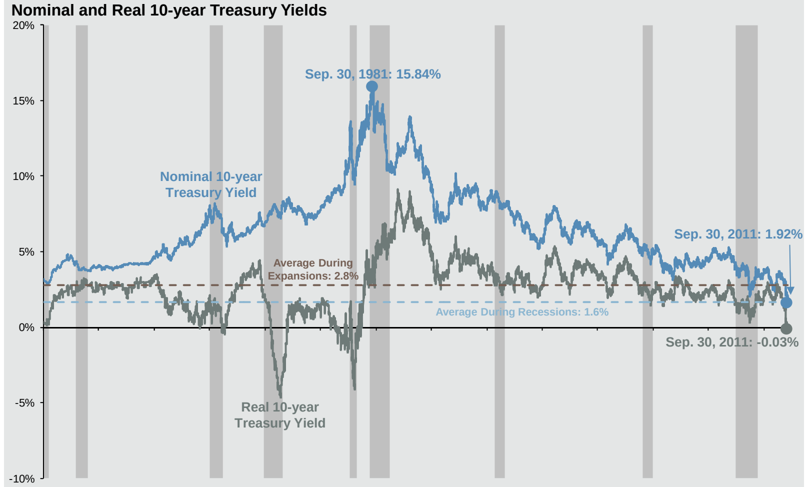
Fixed Income

Nominal and Real 10-year Treasury Yields



Source: Federal Reserve, BLS, J.P. Morgan Asset Management.

Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core inflation for that month except for September 2011 where real yields are calculated by subtracting out August 2011 year-over-year core inflation.

Data are as of 9/30/11.

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MARKET INSIGHTS

Stocks are priced for deep recession

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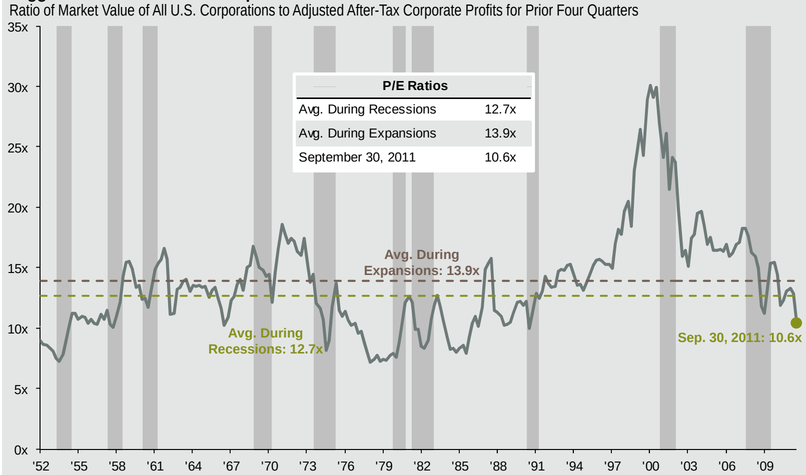
Equities

Lagged P/E Ratio – All U.S. Corporations

Ratio of Market Value of All U.S. Corporations to Adjusted After-Tax Corporate Profits for Prior Four Quarters



Source: BEA, Federal Reserve Board, Wilshire Associates, J.P. Morgan Asset Management.

Data are as of 9/30/11.

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MARKET INSIGHTS

Financials and Technology: Bounce potential

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Equities

	Financials	Technology	Health Care	Industrials	Energy	Cons. Discr.	Cons. Staples	Telecom	Utilities	Materials	S&P 500 Index	
S&P Weight	13.6%	19.4%	12.1%	10.3%	11.6%	10.6%	11.7%	3.3%	4.0%	3.4%	100.0%	Weight
Russell Growth Weight	3.8%	28.8%	11.0%	12.1%	10.3%	14.4%	13.0%	1.2%	0.1%	5.1%	100.0%	
Russell Value Weight	24.7%	8.9%	13.2%	8.8%	11.8%	8.7%	8.2%	5.1%	8.1%	2.6%	100.0%	
3Q 2011	-22.8	-7.7	-10.0	-21.0	-20.4	-13.0	-4.2	-8.0	1.5	-24.5	-13.9	Return
2011 YTD	-25.2	-5.8	2.5	-14.7	-11.4	-5.7	3.4	-1.5	10.8	-21.8	-8.7	
Since Market Peak (October 2007)	-64.0	-7.3	-4.9	-26.6	-18.0	-1.4	18.8	-16.4	-3.9	-25.1	-21.1	
Since Market Low (March 2009)	96.7	94.3	53.4	101.7	50.2	128.1	66.6	59.6	68.3	78.5	76.3	
Beta to S&P500	1.31	1.34	0.63	1.16	0.86	1.14	0.52	0.89	0.61	1.24	1.00	
Forward P/E Ratio	8.4x	11.2x	10.5x	10.7x	8.4x	12.3x	13.4x	14.6x	13.5x	9.2x	10.6x	P/E
15-yr avg.	**13.0x**	**24.2x**	**19.2x**	**17.2x**	**15.1x**	**18.7x**	**19.0x**	**17.4x**	**13.5x**	**16.3x**	**17.0x**	
Trailing P/E Ratio	9.9x	13.0x	14.5x	12.8x	10.4x	14.8x	14.6x	11.6x	14.3x	11.1x	12.5x	
20-yr avg.	**16.0x**	**27.2x**	**24.4x**	**20.5x**	**18.4x**	**19.9x**	**21.3x**	**18.3x**	**14.2x**	**19.7x**	**19.8x**	
Dividend Yield	1.4%	1.1%	2.3%	2.5%	2.1%	1.6%	3.0%	5.5%	4.3%	2.2%	2.3%	Div
20-yr avg.	**2.2%**	**0.6%**	**1.4%**	**1.8%**	**2.0%**	**1.0%**	**2.0%**	**3.7%**	**4.5%**	**2.1%**	**1.7%**	

Source: Standard & Poor's, Russell Investment Group, FactSet, J.P. Morgan Asset Management.

All calculations are cumulative total return, not annualized, including dividends for the stated period. Since Market Peak represents period 10/9/07 – 9/30/11. Since Market Low represents period 3/9/09 – 9/30/11.

Forward P/E Ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next twelve months (NTM), and is provided by FactSet Market Aggregates. Trailing P/E ratios are bottom-up values defined as month-end price divided by the last twelve months of available reported earnings. Historical data can change as new information becomes available. Note that P/E ratios for the S&P 500 may differ from estimates elsewhere in this book due to the use of a bottom-up calculation of constituent earnings (as described) rather than a top-down calculation. This methodology is used to allow proper comparison of sector level data to broad index level data. Dividend yields are bottom-up values defined as the annualized value of the most recent cash dividend as a percent of month-end price. Beta calculations are based on 10 years of monthly price returns for the S&P 500 and its sub-indices.

Past performance is not indicative of future returns.

Data are as of 9/30/11.

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MARKET INSIGHTS

Dividends: The income alternative

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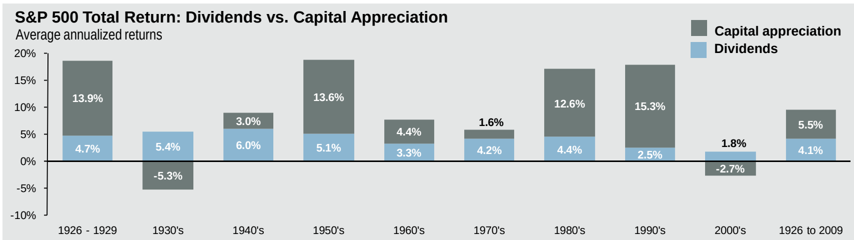
Asset Class

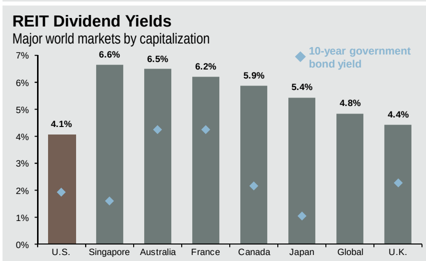
S&P 500 Total Return: Dividends vs. Capital Appreciation

Average annualized returns



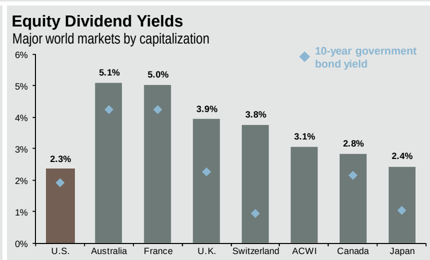
REIT Dividend Yields

Major world markets by capitalization



Equity Dividend Yields

Major world markets by capitalization



Source: (Top chart) Standard & Poor's, Ibbotson, J.P. Morgan Asset Management. (Bottom left) FactSet, NAREIT, J.P. Morgan Asset Management. Yields shown are that of the appropriate FTSE NAREIT REIT index, which excludes property development companies. (Bottom right) FactSet, MSCI, J.P. Morgan Asset Management. Yields shown are that of the appropriate MSCI index.

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High yield bonds: Well compensated risks

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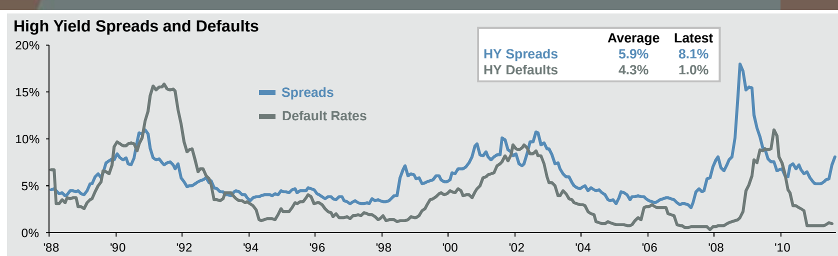
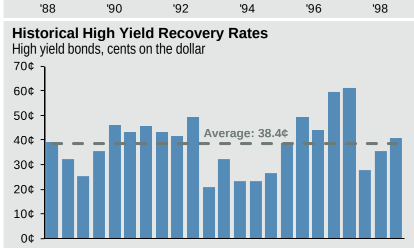
Fixed Income

High Yield Spreads and Defaults



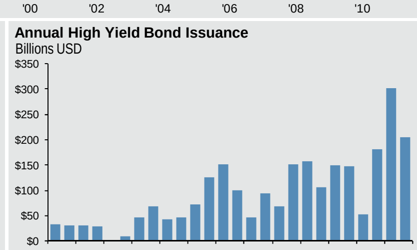
Historical High Yield Recovery Rates

High yield bonds, cents on the dollar



Annual High Yield Bond Issuance

Billions USD



Source (Top chart): U.S. Treasury, J.P. Morgan, J.P. Morgan Asset Management. Default rates are defined as the par value percentage of the total market trading at or below 50% of par value and include any Chapter 11 filing, prepackaged filing or missed interest payments. (Bottom left): J.P Morgan, Moody's, J.P. Morgan Asset Management. (Bottom right): J.P. Morgan Asset Management. Yield to worst is defined as the lowest potential yield that can be received on a bond without the issuer actually defaulting and reflects the possibility of the bond being called at an unfavorable time for the holder.
Spreads indicated are benchmark yields less comparable maturity Treasury yields. Past performance is not indicative of comparable future results.
2011 issuance is as of August 2011.
Data are as of 9/30/11.

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Municipal Bonds: Credit comfort versus duration worries

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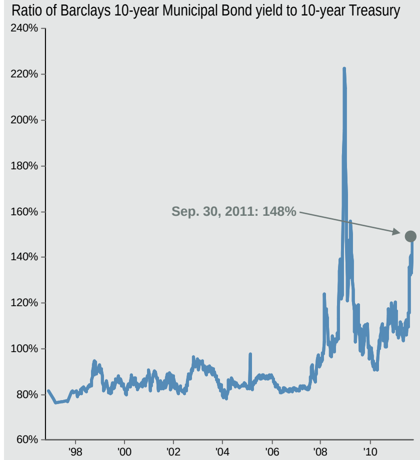
Fixed Income

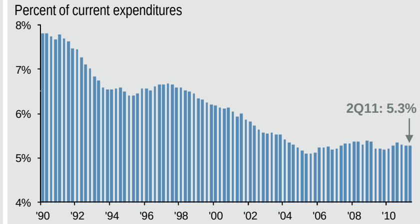
Muni/Treasury Ratio

Ratio of Barclays 10-year Municipal Bond yield to 10-year Treasury



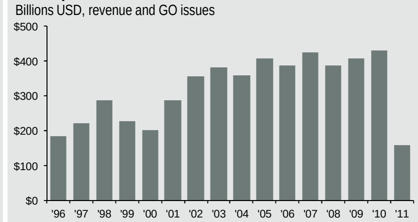
State & Local Government Debt Service

Percent of current expenditures



Municipal Bond Issuance*

Billions USD, revenue and GO issues



Source (Left chart): Barclays Capital, U.S. Treasury, FactSet, J.P. Morgan Asset Management. (Top right) BEA, J.P. Morgan Asset Management. (Bottom Right) SIFMA, J.P. Morgan Asset Management.

*Excludes maturities of 13 months or less and private placements. 2011 issuance data is as of August 2011.

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MARKET INSIGHTS

Time and diversification: The antidotes to volatility

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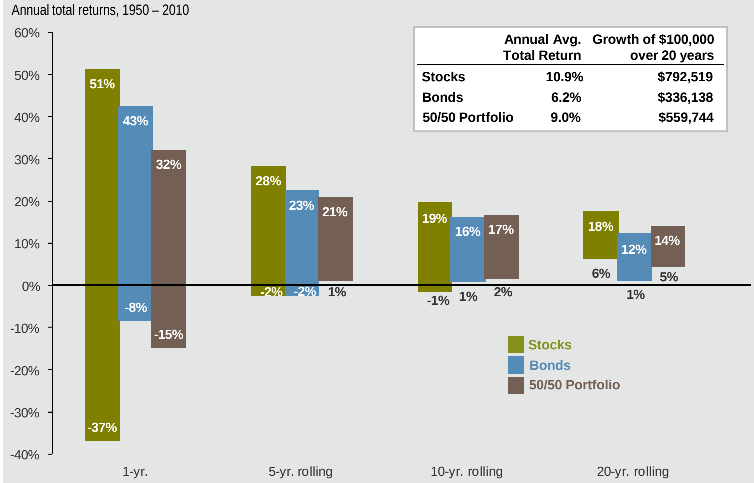
Asset Class

Range of Stock, Bond and Blended Total Returns

Annual total returns, 1950 – 2010

	Annual Avg. Total Return	Growth of $100,000 over 20 years
Stocks	10.9%	$792,519
Bonds	6.2%	$336,138
50/50 Portfolio	9.0%	$559,744



Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.

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Consumer sentiment and the best time to buy?

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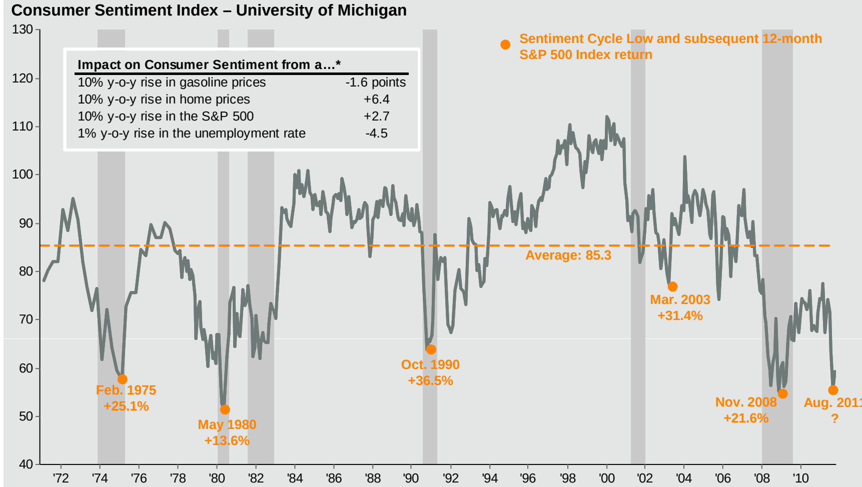
Economy

Consumer Sentiment Index – University of Michigan



Source: University of Michigan, FactSet, J.P. Morgan Asset Management.

*Based on regression analysis of monthly data from Jan. 1998 to Feb. 2011.

Data reflect most recently available as of 9/30/11.

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